

INSTITUTE AND FACULTY OF ACTUARIES

EXAMINERS' REPORT

September 2020 Examinations

Subject CP3 – Communications Practice

Introduction

The Examiners' Report is written by the Chief Examiner with the aim of helping candidates, both those who are sitting the examination for the first time and using past papers as a revision aid and also those who have previously failed the subject.

The Examiners are charged by Council with examining the published syllabus. The Examiners have access to the Core Reading, which is designed to interpret the syllabus, and will generally base questions around it but are not required to examine the content of Core Reading specifically or exclusively.

For numerical questions the Examiners' preferred approach to the solution is reproduced in this report; other valid approaches are given appropriate credit. For essay-style questions, particularly the open-ended questions in the later subjects, the report may contain more points than the Examiners will expect from a solution that scores full marks.

The report is written based on the legislative and regulatory context pertaining to the date that the examination was set. Candidates should take into account the possibility that circumstances may have changed if using these reports for revision.

Mike Hammer
Chair of the Board of Examiners

December 2020

A. General comments on the *aims of this subject and how it is marked*

Subject CP3 consists of two parts as follows:

1. Written communication (90 marks)

Produce a written piece of communication that explains a scenario typically faced by an actuary in their day to day work. This communication will be aimed at a non-actuary, although the target audience's level of financial knowledge and understanding will vary from question to question.

The communication needs to be of a standard that it would be acceptable as a first draft. It is important that the recipient would both understand the communication and be satisfied with the response. The marking schedules include details of the marks awarded including the necessary content. To the extent that it makes the communication unclear or confusing for the audience, marks may also be lost for including irrelevant content or details that candidates have specifically been asked to exclude from their solution.

2. Reflective questions (10 marks)

A set of questions designed to allow candidates to consider the approach that they took in their communication and justify certain decisions. For example, candidates may be asked what information they felt was relevant for this audience, or which terms they specifically excluded because they would constitute jargon.

Candidates are provided with some background reading a few days before the exam (the Scenario Material) to allow them to familiarise themselves with the scenario without being under exam conditions. Candidates are expected to read the information provided, but are not required to do any further reading or research around the scenario.

B. Comments on *candidate performance in this diet of the examination*

Candidates were asked to draft a meeting paper for the Sales Machine Marketing Committee setting out and justifying the proposed changes to the sales process of the ABC Funeral Insurance Plan. The committee members are described in the Scenario Material, and while they are experienced business leaders, they do not have prior experience with life insurance products. Financial literacy can therefore be assumed, but any insurance-specific topics should be clearly explained.

A good answer typically included:

- An introduction giving some background and signposting the key content of the paper.
- A high level explanation of the two key changes, and the motivation for making them.
- An outline of the financial impact of the changes, focussing on the profit before tax, which is a key KPI for the committee.

Candidates who scored poorly generally struggled to identify the level of detail that was needed for the paper. Some included far too much information, such as lots of detail about the changes, the questions to be asked, and the impact on various metrics. A paper for this audience should be concise and include just the most pertinent facts. The instruction was to produce a paper to explain the merits of the proposed changes, which is best done by explaining each change, why it impacts the financial results, followed by an illustration of the impact on the metrics that the committee are most focussed on.

Others did not give enough background and assumed too much prior knowledge. While the committee will no doubt have covered the basics of life insurance when discussing the product previously, these will be busy professionals who see many proposals and initiatives in their professional lives. It is therefore important to reiterate the fundamental differences between insurance and other products to clearly communicate the impact of the changes. This is particularly important in this case because the two changes focus on the two elements that are specific to insurance – reducing lapses and claims.

Some candidates failed to pick up relatively easy marks for basic formatting and structuring that is typically required in a CP3 answer. Examples include:

- Always ensuring that the communication is clearly addressed to the audience.
- Clearly identifying the author of the paper.
- Labelling the axes on charts.
- Splitting the document into sections focussing on each point, and giving each a clear sub-heading.

Candidates should also ensure that they always read the question carefully, and only include facts and figures from the scenario material or question paper in their answer. A number of candidates added features to the product or sales process, perhaps based on how products of this type work in their market.

There were also examples of misreading the question, particularly in question two. Q2 (iii) for example asks the candidate to explain why they decided to include the data that they did include. This is focussed the filtering of data, not on how the data is presented. A number of candidates elaborated in this question on the type of chart used in their answer.

It is also worth reiterating some points made on the previous examiners report, as the following issues were seen again in this diet:

- There is no need to produce a covering email to the contact within the company who has asked you to draft the communication.
- There is no need to add a word count.

C. Pass Mark

The pass mark for this exam was 55.

1,560 presented themselves and 809 passed.

Example Solution

Question 1

To: Members of the Sales Machine Marketing Committee

From: Alex Smith – ABC Insurance

Date: 15 September 2020

Adjustments to the ABC Funeral Insurance Plan sales script

As we are nearing the launch date, some final decisions need to be made regarding the product and sales campaign. These decisions are likely to have a significant financial impact in the long-term success of the project.

SalesMachine currently earns 90% of its revenues each month by sales from that month. For example, where an Ab-Monster 3000 is sold today, that revenue and profit is recognised immediately. This is true whether the client uses the device for many years to come, or it ends up in the basement after 3 months.

However, insurance products work differently. Since insurance is a long-term contractual agreement between the insurer and the customer, the long-term experience on each policy is very important. Two important factors are the duration that each policy is in-force and continues to pay premiums, and the claims experience.

This paper outlines two proposed changes to the sales process aimed at improving both of these factors, and shows the expected impact on profitability.

Policy Duration

Funeral insurance customers pay a premium each month in return for a fixed sum-assured payable on death. Customers who stay longer will pay more premiums thereby improving the profitability on that policy. One significant reason for customers terminating their insurance cover early is that customers purchase cover without having a clear financial need for the benefit. These customers may pay a few premiums but then quickly realise that this monthly expense is not justified.

Our recommendation is that SalesMachine include questions in the sales process to ensure that there is a financial need for the product. For example, our sales process should ensure potential customers earn enough to afford the premiums, and have dependents who would benefit from the sum-assured on death. While this will lengthen the sales-call by two to three minutes, reducing the number of sales an advisor can make, those who ultimately buy a policy do need it and will therefore continue to pay premiums for longer. Currently we expect 10% of our customers to leave each month. This change is likely to reduce that by half to 5% per month.

Likelihood of Claims

In calculating the premiums for ABC Funeral Insurance Plan we have made some assumptions about the health of the customers and therefore likely death rates. However, if we can reduce the

risk by limiting the number of unhealthy customers buying policies, we can reduce the number of claims that need to be paid, improving long-term profits.

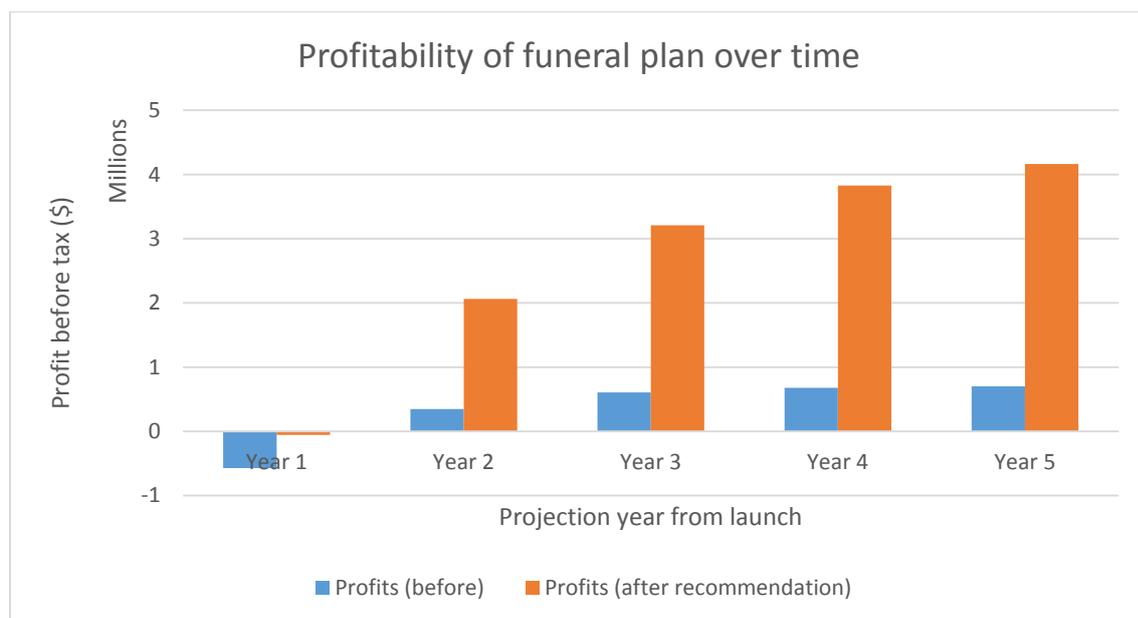
Our second recommendation is that we include five basic medical questions. This will allow us to identify pre-existing conditions upfront to decline cover or explicitly exclude cover for these conditions. Currently we rely on the fact that conditions that pre-date the purchase of the policy are excluded from cover, but with just 24 hours to finalise claims, we will not be in a position to thoroughly investigate claims to the level of rigour we would like. This will lead to invalid claims being paid where we do not have time to obtain and scrutinise medical records to ascertain any conditions that pre-date the purchase of the policy. Therefore it is important to capture this information upfront at sales stage. This should lower the amount of premiums paid out as claims from 70% to 50%.

Financial Implications

As the sales script currently stands, we expect to sell 6,600 policies per month. When lapses are taken into account, at the end of five years we expect to have around 66,000 customers in force. If we implement the recommendations to screen for customer need and ask medical questions upfront, we expect to sell 20% fewer policies per month, because fewer people will qualify for the product. Furthermore, each call will be longer and we will therefore need more sales-agents to dial the same number of potential customers.

While this may appear to be a worse result, the quality of the business is much improved. This improved quality manifests itself in more premiums paid over time as customers keep their funeral cover for longer. Indeed, after five years we project that there will be around 100,000 customers in force, a 66% increase. Also, the amount we pay out in claims will reduce as we cover fewer people with known health problems.

On balance, the benefits of making these changes far outweigh the impact of lower sales volumes, especially in the long-term. This is clearly seen in the chart below.



Conclusion

In conclusion, insurance sales requires one to think not only about maximising policy volumes, but also about the likely long-term experience of those policies. It is often worthwhile having fewer customers who pay premiums for longer and with lower claims, than more customers who lapse their policy quickly and claim more.

We have the ability to improve both these metrics by adjusting the sales script to filter out poor risks. Overall this is likely to have significant financial advantages for the joint-venture in the longer term.

Question 2

2 (i)

- Set out the differences between insurance business and traditional business up-front - to appreciate the changes the committee need to understand that volume of initial sales is less important than persistency and ongoing claims levels for insurance. Highlighting these differences right at the start of the paper puts this at the forefront of their mind.
- Highlight the number of policies in force - The committee are used to thinking about the number of sales as a key metric that implies profitability. Given that insurance premium is constantly earned, the number of policies in force is an equivalent metric for insurance business. Presenting this information clearly will help the committee to focus on other metrics than volume of sales
- Produce a clear chart with profit before tax - ultimately the committee are incentivised by the profit before tax earned. Showing that this improves significantly under this scenario will emphasise the benefits of the updates approach. Even if they have skimmed the initial sections and not fully grasped the concepts, having this chart clearly towards the end of the paper will bring home the key message and will likely encourage them to review the key drivers.

2 (ii)

- Lapse risk – the committee will not be familiar with the concept of lapse risk as it does not feature in the products they have been selling to date. Instead, the risk of a customer surrendering the product and stopping their premium payments is described.
- Loss ratio – this term will only be familiar to those who have considerable knowledge of insurance pricing. Instead, the concept of the proportion of premiums that are ultimately paid out in claims is described.

2.3

- The committee are measured on revenue and profit before tax. Peter also mentioned that profit before tax would be an important consideration for the committee. By showing the profit before tax on the chart I could make it clear the dramatic increase that these initiatives would bring, which will appeal to the committee.
- I tried to shift the focus away from a purely short-term sales focus to a long-term profit view. I therefore chose a chart with a longer time horizon than the committee would be likely to consider for other products.

END OF SAMPLE ANSWER

Mark Scheme

Q1

FORMAT

Document Format [up to 3 marks]

| | |
|---|-----|
| Clearly addressed to the Marketing committee (in header of first line of paper) | [1] |
| Suitable title for paper - mentions changes to the sales process | [1] |
| Date, author (acceptable for author to come at end of document) | [1] |

Planning and presentation [Up to 12 marks]

-Grouping of ideas

Document is grouped into an appropriate number of sections (excluding introduction and summary).

Award 2 marks if 3-6 sections, 1 mark if 2 or 7 sections, otherwise 0 marks. [2]

-Logical order of points.

Logical order between sections. When awarding marks here, consider the overall heading and purpose of the section rather than the content within it.

If read once and clear then 2 marks, if needed to re-read parts then 1 mark, otherwise 0 marks. [2]

Logical order of points within each section. When awarding marks here consider the order of points within each section. If read once and clear then

3 marks, if one section needed to be re-read then 2-1 marks, otherwise 0 marks. [3]

Points within each section are directly relevant to the heading. [1]

Appropriate short headings on each section [2]

Give a mark to each appropriate heading up to 2 marks in total. Long headings or headings that don't succinctly describe what follows don't get a mark.

Sentences kept brief [2]

Award 2 marks if there are no overly long sentences. Award 1 mark if there is one overly long sentence. If more than one overly long sentence, award 0 marks. The principle is that a sentence containing more than one message or too many sub-clauses is too long, or, if spoken, needs repeated breaks to articulate.

Format of visual aids [Up to 5 marks]

Clear chart showing the profit before tax over five years - three marks broken down as follows:

- Be a bar chart with easily comparable before and after bars [1]

- Ensure the before and after bars are clearly labelled [1]
 - Have a clear title [½]
 - Have all axes well labelled [½]
-
- A second chart showing data that is relevant to the paper
 - Chart is clear and chart type is appropriate for the data being shown [1]
 - Have a clear title [½]
 - Have all axes well labelled [½]
- [Total 20]**

LANGUAGE

Overall language [Up to 7 marks]

- Language used is simple and will be easily understood by the trustees. Award:
- 5 marks if the document is understandable as a whole
 - 4-3 marks if up to two points need to be redrafted
 - 2-1 marks if three to four points or one section needs to be redrafted
 - 0 marks if more than four points or more than one section needs to be redrafted [5]
- Professional tone (avoid comments which “talk down” to the committee). [1]
- Avoid colloquialisms, informal and/or emotive language. [1]

Jargon and terminology [Up to 12 marks]

Absence of technical terms. Award 4 marks if there are no terms present which are too technical for the recipient. Award 2 marks if there is one unexplained technical term. If there are two or more unexplained technical terms, award 0 marks. A list of jargon terms is supplied below which will include unnecessary technical terms where a simpler term exists, terms and/or abbreviations which may be acceptable but are unexplained. [4]

Superfluous accuracy of numbers (such as too many decimal places) is avoided. Award 3 marks if all numbers quoted use an appropriate level of accuracy. Award 2-1 marks if up to two numbers quoted in the text or up to six numbers in a table have been quoted with excessive accuracy. If more numbers have been quoted with excessive accuracy award 0 marks. [3]

Absence of irrelevant points of content. Award 5 marks if no irrelevancies, award 3 marks if one irrelevant point, 1 mark if two irrelevant points. If more than two irrelevant points award 0 marks. [5]

Examples of irrelevant points (not an exhaustive list):

- In detail recap from the current business plan
- Detail of the proposed wording changes to the script
- breakdown of profit into all its components (different expenses)

- references to the probability of making a claim (the proposals are not trying to reduce the number of valid claims, just make it more likely that invalid claims are picked up)
- detailed numbers relating to any change from current to proposed (e.g. changed call times, changed commission amounts)

Grammar, spelling and punctuation [Up to 3 marks]

Award 3 marks if no significant grammatical, spelling or punctuation errors, 2 marks if one error, 1 mark if two errors. Award 0 marks if more than two errors. Each “error” should be significant enough to compromise the professionalism of the document or require sections to be redrafted. [3]

[Total 22]

CONTENT

Marks shown are to be awarded for each item of content identified in the candidate’s answer. To be credited with the mark(s) the point needs to be clear and understandable. However, points that require only minor adjustment should be credited.

Markers should use discretion when there is more than one mark for a point, awarding part marks to reflect the level of clarity.

Markers should also use their discretion when considering clarity to ensure that, for example, candidates who cover most of the content items, but not very clearly, are still given some credit, rather than penalised for every point made.

1. Introduction / executive summary / conclusion [Up to 7 marks]

Key decisions now need to be made on the marketing campaign [1]

Signpost the key points that are being made in the paper:

- Changes to the sales process to reduce lapses [1]
- Gathering information about pre-existing conditions to reduce invalid claims [1]
- Update to business plan showing higher profitability as a result of these changes [1]

Restate that the current business model means profits are made immediately rather than expecting a long term income stream [1]

Insurance works differently profits are longer term in nature [2]

2. Policy duration [Up to 12 marks]

- The longer a policyholder has a policy, the more profitable they are for the insurer [2]
- Ensuring policyholders have a clear need for the product is key [1]
- Policyholders who do not really need the product will soon cancel the policy when premium payments continue to be made monthly [1]
- Therefore it makes sense to check there is a need for the policy during the sales process [1]

- Customers must be earning enough to need the cover [1]
- Customers must have some dependants who would benefit from the cover [1]
- This will increase the length of the sales call [1]
- But this is expected to reduce the number of customers who lapse each month from 10% to 5% [1]
- Each customer will therefore have their policy and continue to pay premiums for longer [1]
- This will lead to more policies being in force over time, and therefore more profit generated over time [1]
- even though it will reduce the initial number of policies sold [1]

3. Cost of claims [Up to 10 marks]

- Pre-existing conditions are excluded [1]
- However, in 24 hours it is difficult to verify that a claim is not as a result of a pre-existing condition [2]
- Therefore invalid claims may be paid [1]
- Recommend that we ask about the health status during the sales call to record pre-existing conditions [1]
- Claims can then be checked against this information identify invalid claims [2]
- The change should mean that the average amount of premium paid out as a claim will drop from 70% to 50% [1]
- Significant reduction in the amount paid out in claims by not paying as many invalid claims will significantly improve profitability [2]

4. Financial implications [Up to 7 marks]

- Summary of the number of policies in force [2]
- Confirmation that the implementation of the recommendations will reduce the number of new customers per month [1]
- However, this is more than offset by the persistency of the business [1]
- and the lower claims paid [1]
- Show impact on profitability over time [2]

5. Summary [Up to 4 marks]

- Important to consider factors other than volumes such as cost of claims and persistency of business for insurance [2]
- Adjusting the sales script will improve profitability in the long term [2]

[Total 40]

MEETING OF OBJECTIVES

6-8 marks

The committee will be completely satisfied with the response to the question and the responder has made a good impression on the committee.

The communicated answer is clear and easy to read, the response flows through to a conclusion. It looks good, it is well set out, and it has the right tone of voice. It satisfactorily

and completely answers the question. The responder has made a good impression on the committee.

3-5 marks

The committee is left with some question marks over the responder, and therefore over aspects of the answer given.

The committee has been given an answer that is partially understandable although the response does not quite flow freely through to a conclusion. Some information in the argument is obviously missing and/or there are one or two visual mistakes and anomalies in the look of the response. Some technical terms may have been used that are not entirely clear. The committee are left with some question marks over the responder, and perhaps therefore over aspects of the answer given.

0-2 mark

The committee is left with a poor impression of the responder, is confused by the answer and/or does not trust the answer.

The answer will leave the Committee confused. The communication is poorly written or possibly too technical. There are some obvious mistakes in the arguments, tables or charts do not make sense and/or are not properly labelled. The answer does not flow, but rather jumps around. The layout is not consistent throughout the communication. There may be spelling mistakes or the Committee have not been properly addressed. The tone of voice is wrong, perhaps too informal. The committee have been left with a poor impression of the responder and therefore do not trust the answer.

[Total 8]
[Total Q1 90]

Q2

REFLECTIVE

- (a) Structure to tackle an unfamiliar concept with the audience (Candidates are asked to 'explain' - looking for three points with explanations (award one mark per valid point and one mark for the point being well explained. Examples are below, but alternatives should be credited. Where more than three, credit best three answers)
- Set out the differences between insurance business and traditional business up-front - to appreciate the changes the committee need to understand that volume of initial sales is less important than persistency and ongoing claims levels for insurance. Highlighting these differences right at the start of the paper puts this at the forefront of their mind.
 - Highlight the number of policies in force - The committee are used to thinking about the number of sales as a key metric that implies profitability. Given that insurance premium is constantly earned, the number of policies in force is an equivalent metric

for insurance business. Presenting this information clearly will help the committee to focus on other metrics than volume of sales

- Produce a clear chart with profit before tax - ultimately the committee are incentivised by the profit before tax earned. Showing that this improves significantly under this scenario will emphasise the benefits of the updates approach. Even if they have skimmed the initial sections and not fully grasped the concepts, having this chart clearly towards the end of the paper will bring home the key message and will likely encourage them to review the key drivers.

[Max 6]

(b) Jargon (TWO examples required, 1 mark each)

Markers should look for valid examples of jargon (see jargon list) and award half a mark for the jargon and half a mark for the explanation of why it is jargon for that audience.

Note that to gain a mark the jargon should have been excluded because it was jargon, rather than because it was irrelevant. For example, ‘Loss ratio’ should be excluded as jargon, and rather a candidate might write ‘the claims payments as a proportion of the total premium received’. However, ‘mortality improvement factor’ may be jargon for the audience, but is irrelevant to the paper that the candidate is drafting, and therefore is not an acceptable answer for this question.

[Max 2]

(c) Showed the figures the committee are actually measured on. [1]

Ensured I showed a reasonable time horizon because of the long-term nature of my point. [1]

[Max 2]

[Total Q2 10]

Jargon List

| Usually Jargon | May be Jargon | Not Jargon |
|-------------------------|---------------------------|-----------------|
| Loss ratio | Claims ratio | Commission |
| Modelling | Screen for financial need | Volatility |
| Persistency | Retention | Renewal premium |
| Underwriting | Exclusions | Sum assured |
| Lapse risk | Lapse | Customer base |
| Pre-qualifying question | In-force | |
| Earned premium | Death rate | |
| Lapse rate | Conversion rate | |

[Paper Total 100]

END OF EXAMINERS’ REPORT